An Analysis of Single Family Residences and Townhomes in Los Angeles as an Investment

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Purchasing a home has long been one of the most important financial decisions and big purchases one makes in their life. However, recently rising market prices and a large influx of people moving to large cities, such as Los Angeles, has driven housing prices far beyond many people's budgets. In fact, affordability is going down at such a rapid rate that currently only 30% of LA County residents actually own a home. Additionally, Los Angeles is currently ranked as the fourth most difficult market for first-time homebuyers to delve in to. Many LA County residents have decided against ever purchasing a home because of the increasing disparity between income levels and housing prices. This paper examines the Los Angeles housing market as a whole, specifically focusing on the pros and cons between single-family residences and townhomes. The goal is to ultimately pin-point the better vehicle of investment for one's money between the two and offer some industry secret best practices for investing in each respective type of real estate. These industry tips are being shared by professionals who have been investing or facilitating investments in the Los Angeles real estate market for an average of about 11 years.

Key Words: Los Angeles, Real Estate, Investment, Housing, Single-Family, Townhome, Attached-Unit, Residence

Introduction

Average housing prices in the Los Angeles area have been disproportionately increasing in relation to the median incomes in the area. This increasing disparity has made Los Angeles the fourth most difficult market for first-time homebuyers to enter. While 88% of households in the U.S. believe that owning a property is a pragmatic financial decision, many Angeleno's don't have any intentions to purchase a residence in their hometowns due to the generally high price points of these properties.

California is home to some of the most difficult housing markets to enter, with five of the ten most difficult markets to invest in being located throughout the state. However, a difficult market does not equate to an impossible market to get in to and the Los Angeles housing market has historically proven to be a good investment. In fact, Los Angeles housing market prices continue to rise, although they are rising at a slower rate than they were in the first five years of the decade (2010-2015). This is due to the continual increase in jobs in the area. Across California, the increase in jobs being created hovered around 1.8%, in comparison to the nationwide growth of 1.5%. Los Angeles County alone added over 63,000 jobs within the year. Such rapid growth in the Los Angeles County workforce leads to an even greater demand for housing. This extremely rapid growth and demand for housing while the housing supply stays fairly stagnant explains the consistently rising housing prices in the area. With new developments constantly being built in the heart of Downtown Los Angeles and throughout Los Angeles county, the demand for housing is projected to continue its rapid increase.

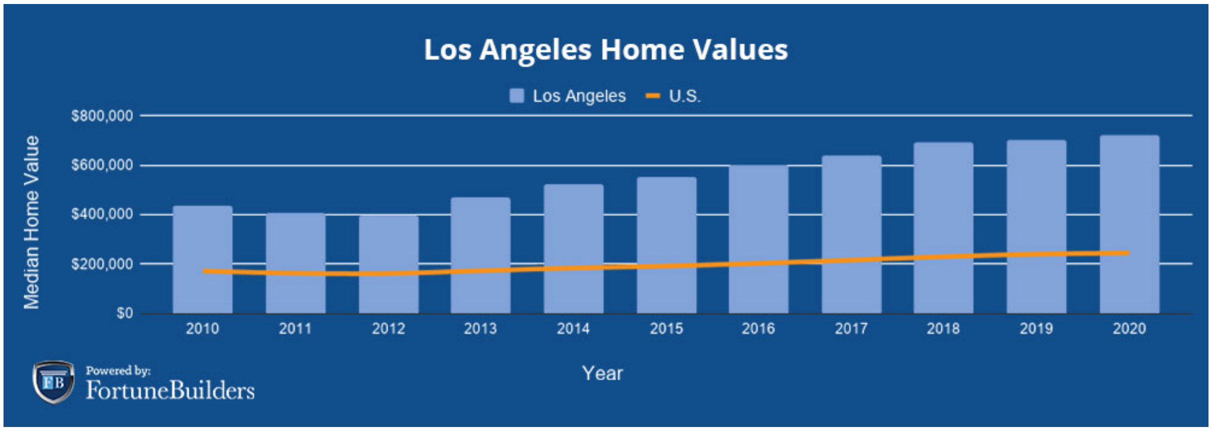

Figure 1: Los Angeles Home Values over the Decade
Source: FortuneBuilders, data provided by Zillow

As shown in Figure 1, median Los Angeles home values have continued to rise since 2012 while the national home values have stayed fairly stagnant. Not only is this positive for homebuyers looking to invest in properties, but it is also a plus for investors looking to purchase residences to rent out. Los Angeles is known to have a large renter population, with renters coming from all of the different age groups and income levels.

Those with higher incomes are looking to rent smaller, more extravagant residences in nicer areas. On the other hand, those with lower incomes are still looking to rent, though they are not interested in extremely extravagant properties. Instead, those with lower incomes are looking for cheap and affordable rental properties that they can afford, as being a homeowner can be quite expensive, particularly in the Los Angeles area. Both the younger and older generations are looking to rent as well, albeit for different reasons. The younger generation have demonstrated trends toward smaller family sizes, usually just consisting of themselves and a partner and occasionally one or two children. Due to the smaller family sizes, they prefer to rent in order to avoid homeowner maintenance costs and other maintenance issues that come with owning a home. The older generations on the other hand are looking to rent because they no longer want to have to maintain a residence in their old age. These renters are looking for well-maintained properties with property management companies that ensure routine maintenances throughout the year. Another aspect that is unique to the Los Angeles renter community is that there are many local military bases. Many of these military families choose to rent a property in Los Angeles rather than living on base. This also adds to the renter market in the LA area.

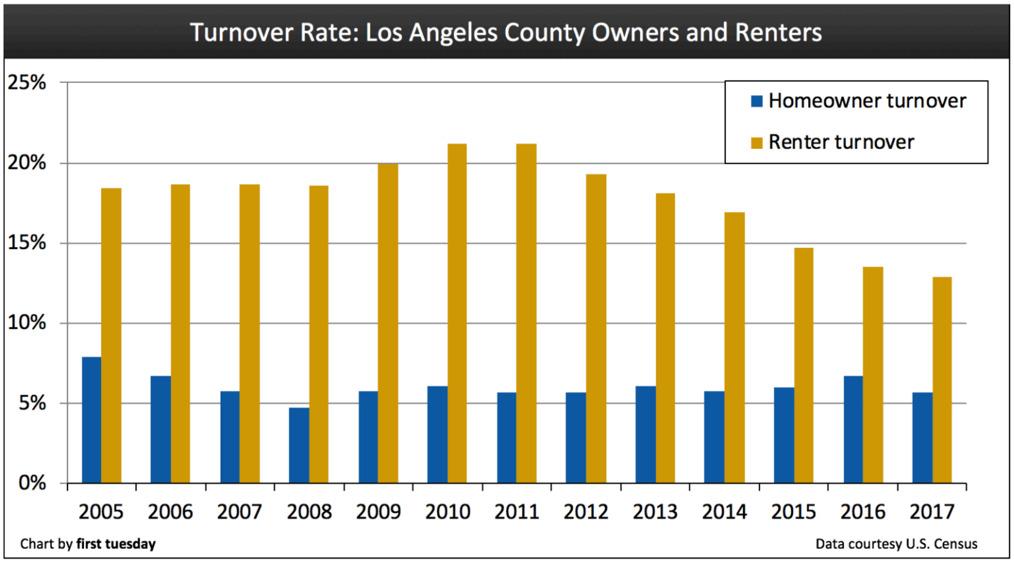

Figure 2: Los Angeles Homeowner and Renter Turnover Rates
Source: FirstTuesday

Methodology

The research methodology for this paper consisted of gathering data from previously conducted case studies and peer-reviewed scholarly journals. Additionally, all of the new information regarding industry provided best practices for investing in real estate came from interviews with industry professionals who have been in the Real Estate industry for an average of 11 years. All of the interviews were conducted over the phone in 25 to 45 minute increments. Interviewees consisted of people working in different sectors of the real estate industry, ranging from real estate agents, to realtors, to corporate real estate investment credit administrators.

The basis of the interview questions aimed to get a general understanding of the interviewee's background in the industry. For example, how they got into the real estate industry, how long they have been working in the industry, different experiences in the industry, and what day to day life looks like for them. The follow up questions aimed to uncover specific stereotypes or common misconceptions about the industry. Additionally, industry best practices or insider tips and items to avoid were also discussed as a result of the follow up questions.

Industry Best Practices

Following the interviews that were conducted with the different industry professionals, several key tips and tricks seemed to be common across the board. These different industry best practices can be condensed into six different key points:

- Instead of trying to enter multiple different markets as they fluctuate, stick to cities with consistent growth in both population and industry. Los Angeles County has consistently shown growth in both of these aspects. Focusing on one area or multiple similar areas allows you to become familiar with the different nuances that are specific to that area. Furthermore, different areas require different investment strategies and investing in too many different areas can be confusing even for a veteran investor.

- Thoroughly get to know the area that you are looking to invest in. One of the best ways, as touted by multiple industry professionals, is to physically drive to each neighborhood and observe the area both from a walking perspective and a driving perspective. Additionally, getting to know the locals in the area and people who live in the specific neighborhood you are investing in provides much more value that most people would expect. The residents' native to that area have knowledge about the community that cannot be looked up online or researched. For example, whether or not the community is a close-knit one, if they have a rotating neighborhood watch person, neighborhood gatherings or book clubs, and much more.
- Stick to your investing plan and do not waver when scare tactics are implemented or you come across some "insider" information about the market declining. Provided that the proper research and analytics were conducted prior to investing, most of the time your best bet is to stick to your original, well developed, plan.
- Pay attention to potential environmental issues. This is often overlooked by new investors, but can ultimately lead to a large unexpected cost. Do research regarding what the residence was prior to being a residence or if there were any possible industrial or hazardous materials being dumped in the area. Another common environmental issue that residential properties are faced with are prior improper septic tank installations that cause the surrounding terrain to be contaminated.
- Find a good realtor that you can trust to have your best interest at heart. This is especially true for those who are looking to enter the industry as they likely do not have their own real estate licenses and do not fully understand the complex mechanics and minute details of the industry. Many little common mistakes can be avoided by finding a realtor that you can trust to help guide you through the process.
- Try to avoid getting too invested into one particular property and developing an emotional attachment to it. This one seemed to be a common mistake that the industry professionals saw happening quite often. Similar to when one is trying to barter with a street vendor, the price that you are willing to purchase at is greatly influenced by how much interest you are showing in the particular item being sold. Often times, newer buyers end up accepting a lower rate of return solely because of the fact that they developed an emotional attachment to the property and were not willing to let it go. Treat the property as an investment and an investment only.

General Analysis

Single Family Residences vs. Townhomes

Single family residences and townhomes or attached-unit residences are not as fundamentally different as people seem to believe. However, they do still share differences that need to be considered when looking to invest.

Structural features are one of the biggest differences between townhomes and single family residences. Townhomes, also known as attached-unit homes, share at least one other wall with another unit, hence the name attached-unit homes. On the other hand, single family residences do not share any walls and sit on their own designated piece of land. This also lends to the amount of front or back yard space each residence provides. Single family residences generally have much larger front and back yards, while townhomes have historically had very little, if any, back yard space due to the nature of the building. Additionally, townhomes are built with the intention to create more units per parcel of land. This coupled with the fact that walls are shared with attached units lends to decreased privacy and increased noise levels.

Another one of the main differences between a single family residence and a townhome is the community. Living in a townhome subjects one to Homeowner's Association fees and rules. These rules and regulations also make it harder to modify the property in any way. The Homeowner's Association generally looks to hold areas to certain levels of uniformity and as a result, changes tenants want to make are generally out of question. This is also a factor to consider for people looking to eventually grow the property to meet either personal desires, or to accommodate for the changes of a growing family.

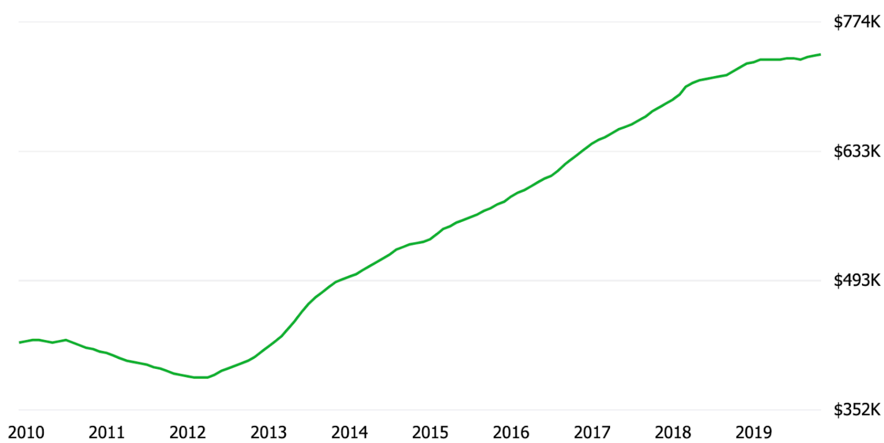

Figure 3: Los Angeles Single Family Residence Median Value
Source: Zillow

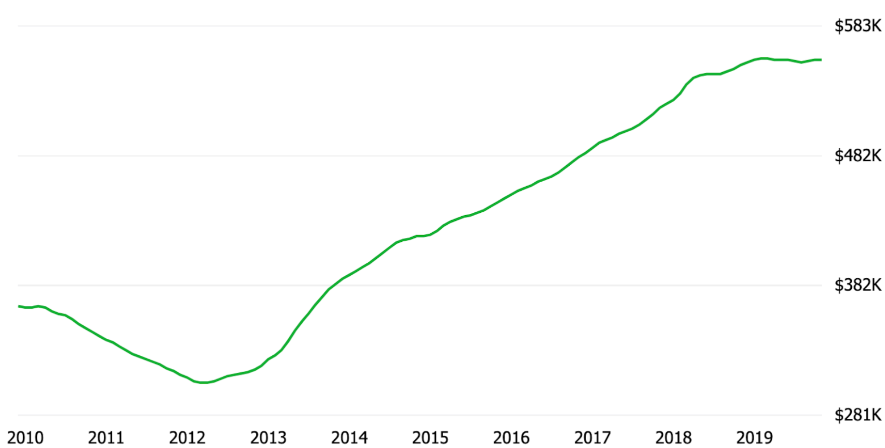

Figure 4: Los Angeles Townhome Median Value
Source: Zillow

As shown in figures three and four, both single family and townhome values in Los Angeles have been generally increasing following the slight dip in 2012. However, the single family residences have historically shown a higher and steadier rate of growth.

Conclusion

Currently, there is an increasing number of college graduates who are forced to live with their parents in the years following their graduation as the housing prices in Los Angeles and other large cities are on the higher end of the spectrum. Additionally, the rapidly growing workforce and limited number of residences creates a shortage in housing. This paper has analyzed single family residences against townhomes in the Los Angeles area and determined that investing in a single family residence with the proper strategy is the path to take to receive the most value for your dollar in the shortest amount of time. Single family residences offer much more flexibility in expansion and remodels, generally larger lot sizes with more front and backyard space, lack of expensive additional fees such as Homeowner's Association fees, and offer increased privacy. Furthermore, there are more opportunities to invest in single family residences in Los Angeles county as about half the county is zoned for single family residences. Utilizing these facts coupled with the industry provided best practices and tips and tricks, one should be able to successfully invest in one of the more difficult, but also one of the most lucrative real estate markets.

Future Research

Future research should look to continue to monitor housing prices in the Los Angeles area, or another area of interest, while applying the same principles discussed in this paper. As Los Angeles is constantly being redeveloped, amenities local to residential neighborhoods are constantly changing which greatly affects property values. These items should be reevaluated for future investment purposes. Consumer demand is also constantly changing and single family residences may no longer be as lucrative of an investment as they are now. Generation Z and millenials are going to be the main new buyers in the upcoming decade and generation z has shown to exhibit very different behavior than all the generations prior so these wants and needs should be reevaluated for future investing.

Additionally, while the real estate market has not historically shown dramatic change in trends or the way the industry operates, there are always new techniques or best practices being developed and discovered. These items should be reevaluated and modified to better suit the investing needs of the upcoming new decade.

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